

# AUDITOR'S REPORT OF THE AUDITOR-GENERAL TO THE MPUMALANGA LEGISLATURE AND THE COUNCIL ON THEMBSILE HANI LOCAL MUNICIPALITY

## REPORT ON THE FINANCIAL STATEMENTS

### Introduction

- I was engaged to audit the accompanying financial statements of Thembisile Hani Local Municipality, which comprise the statement of financial position as at 30 June 2010, and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages xx to xx.

### Accounting officer's responsibility for the financial statements

- The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and in the manner required by the Local Government: Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA). This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

### Auditor-General's responsibility

- As required by section 188 of the Constitution of South Africa, 1996 (Act No. 108 of 1996), section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the International Standards on Auditing and General Notice 1570 of 2009 issued in Government Gazette 32758 of 27 November 2009. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

### Basis for disclaimer of opinion

#### Accumulated surplus

- I was unable to obtain sufficient appropriate audit evidence regarding a variance amounting to R6 652 596 between the opening balance of the accumulated surplus according to the financial records to the amount of R8 336 071 and the closing balance of the prior year's financial statements to the amount of R1 783 475.
- A disclaimer of opinion was issued on the prior year's financial statements, and I was unable to determine the extent of the effect of these limitations on the balances at 30 June 2010 and the results for the year then ended.
- I was unable to obtain sufficient appropriate audit evidence regarding a variance amounting to R8 460 528 between the change in accounting policy to the amount of R302 859 896 disclosed in note 29 to the financial statements and the amount disclosed in the statement of changes in net assets to the amount of R311 320 424.

7. I was unable to obtain supporting information and explanations for debit transactions amounting to R350 473 242 and credit transactions to the amount of R581 633 029, that were processed through the accumulated surplus account, due to limitations placed on the scope of my work by the municipality.
8. I was unable to perform any alternative procedures and, accordingly, could not obtain sufficient appropriate audit evidence as to the accuracy, completeness and existence of the closing balance of accumulated surplus as at 30 June 2010 to the amount of R334 673 797 and at 30 June 2009 to the amount of R1 783 475, as disclosed in the statement of financial position.

#### **Cash and cash equivalents**

9. The municipality could not provide sufficient appropriate audit evidence to support the reconciling items totalling R22 107 327 between cash and cash equivalents stated on the year-end bank reconciliation at R74 430 240 and the cash at banks amount stated in note 13 to the financial statements at R52 322 913. The municipality could not provide sufficient appropriate audit evidence to support payments made to the amount of R14 250 502 and journals made to the amount of R12 589 901. A disclaimer of opinion was issued on the prior year's financial statements, and I was unable to determine the extent of the effect of these limitations on the balances at 30 June 2010 and the results for the year then ended. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the rights, completeness, and valuation and allocation of cash and cash equivalents to the amount of R 80 003 442 as disclosed in the statement of financial position.

#### **Cash flow statement**

10. I was unable to obtain sufficient appropriate evidence as to completeness and accuracy of the cash flow information due to numerous items contributing to the disclaimer of audit opinion that affected items in the statement of financial position and the statement of financial performance.

#### **Clearing or suspense accounts**

11. The municipality could not provide sufficient appropriate audit evidence to support transactions in the salaries clearing account to the amount of R47 801 355. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the existence, obligations, completeness, and valuation and allocation of the salaries clearing account balance to the amount of R16 700 359, as disclosed in note 4 to the financial statements. A disclaimer of opinion was issued on the prior year's financial statements, and I was unable to determine the extent of the effect of these limitations on the balances at 30 June 2010 and the results for the year then ended.
12. The municipality could not provide sufficient appropriate audit evidence to support the journals made in the value-added tax (VAT) output account to the amount of R13 745 363. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the existence, obligations, completeness, and valuation and allocation of the VAT output clearing account balance to the amount of R26 724 865, as disclosed in note 7 to the financial statement. A disclaimer of opinion was issued on the prior year's financial statements, and I was unable to determine the extent of the effect of these limitations on the balances at 30 June 2010 for VAT and the results for the year then ended.

### **Consumer debtors**

13. Consumer debtors to the amount of R18 459 000 could not be traced to the age analysis. Furthermore, I was unable to trace debtor's balances to the debtors account statements and the debtors ledger. I was not able to perform any alternative procedures and, accordingly, could not obtain sufficient appropriate audit evidence as to the completeness, allocation, rights and valuation of consumer debtors to the amount of R94 919 275 as at 30 June 2010 as disclosed in note 10 to the financial statements. A disclaimer of opinion was issued on the prior year's financial statements, and I was unable to determine the extent of the effect of these limitations on the balances at 30 June 2010 and the results for the year then ended.
14. Based on the history of low recoverability of debtors, an impairment loss has not been adequately recognised in accordance with South African Statement of Generally Accepted Accounting Practice, IAS 39 (AC 133), *Financial instruments: Recognition and measurement*. Consumer debtors over 120 days amounts to R78 481 167 while the total provision for the period amounts to R64 844 810 resulting in an under provision of R13 636 957. Had an impairment loss been recognised, accounts receivable would have been stated at R17 942 375, and the surplus for the period and accumulated surpluses would have been reduced by R12 136 957.

### **Employee costs**

15. The municipality could not provide sufficient appropriate audit evidence to support the journals made to the amount of R9 420 287. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the completeness, accuracy and occurrence of employee costs to the amount of R38 305 875 as disclosed in note 17 to the financial statements.

### **Property, plant and equipment**

16. Repairs and maintenance to the amount of R1 667 539 have been capitalised as infrastructure assets. If this amount was recognised as repairs and maintenance expenditure, the infrastructure assets would have decreased by R1 667 539 and accumulated surplus by R1 667 539 as disclosed in note 23.9 to the financial statements.
17. Assets to the amount of R1 495 887 could not be traced to the floor when performing asset verification. Assets verification and reconciliations were not regularly performed and consequently, I was unable to perform any alternative procedures and, accordingly, could not obtain sufficient appropriate audit evidence as to the valuation and existence of the closing balance of other assets to the amount of R17 261 468 as disclosed in note 8 to the financial statements.
18. SA Standards of GRAP, GRAP 17, *Property, plant and equipment* requires that a group of assets of a similar nature or function in a municipality's operations must be classified together. However, I could not verify additions to infrastructure assets to the asset register as they were not correctly classified. Consequently I could not satisfy myself as to the completeness of infrastructure assets to the amount of R34 322 074 as disclosed in note 8 to the financial statements.
19. SA Standard of GRAP, GRAP 16, *Investment property*, requires property held to earn rentals or for capital appreciation to be recognised as investment property. Investment

properties to the amount of R2 446 965 have been classified as property, plant and equipment. If these properties were recognised as investment property, investment property would be increased by R2 446 965 and property, plant and equipment would be decreased by R2 446 965.

20. A disclaimer of opinion was issued on the prior year's financial statements, and I was unable to determine the extent of the effect of these limitations on the balances at 30 June 2010 and the results for the year then ended.

#### Other expenses

21. The municipality could not provide sufficient appropriate audit evidence for expenditure to the amount of R31 194 411. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all goods and services were properly recorded. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the occurrence, completeness, accuracy, cut-off and classification of goods and services of R100 845 073 as disclosed in the statement of financial performance.

#### Payables

22. SA Standard of GRAP, GRAP 19, *Provisions, contingent liabilities and contingent assets* states that accruals are liabilities to pay for goods or services that have been received or supplied but have not been paid, invoiced or formally agreed with the supplier, including amounts due to employees. The municipality did not accrue for invoices in respect of goods and services received amounting to R12 140 166. If these invoices had been accrued for, the effect would have been to reduce the surplus for the period and the accumulated surpluses by R12 140 166 and to increase the accrued liability in the statement of financial position by an equal amount.

#### Provisions

23. A provision should be made for the municipality's present obligation incurred as a consequence of its past use in accordance with the SA Standard of GRAP, GRAP 19, *Provisions, contingent liabilities and contingent assets*. However, no provision for leave was included in the financial statements of the municipality and there was no reliable data available to base the leave provision calculation on, due to the incomplete and inaccurate leave records. Therefore, provision for leave and accumulated surplus as disclosed in the statement of financial performance, were understated by an unknown amount.

24. A disclaimer of opinion was issued on the prior year's financial statements, and I was unable to determine the extent of the effect of these limitations on the balances at 30 June 2010 and the results for the year then ended.

#### Revenue

25. I was unable to obtain sufficient appropriate evidence as to the completeness and accuracy of the interest on outstanding debtors to the amount of R5 548 176 as disclosed in note 24 to the financial statements, due to the effect of the disclaimer of opinion issued on consumer debtors and there were no satisfactory audit procedures that I could perform to obtain reasonable assurance that the interest was properly recorded.
26. Section 77(a) of the Municipal Property Rates Act of South Africa, 2004 (Act No. 6 of 2004) states that "a municipality must regularly, but at least once a year, update its valuation roll by causing a supplementary valuation roll to be prepared. However, the municipality did not

prepare the valuation roll and therefore I was unable to satisfy myself as to the completeness of the property rates revenue to the amount of R3 752 162 as disclosed in note 14 to the financial statements.

27. There was no system of control over licenses and permits revenue on which I could rely for the purpose of my audit, and there were no satisfactory audit procedures that I could perform to obtain reasonable assurance that all the revenue was properly recorded. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness, accuracy and occurrence of licenses and permits revenue to the amount of R7 709 174 as disclosed in the statement of financial performance.
28. The municipality could not provide sufficient appropriate audit evidence to other income of R5 322 424 as disclosed in note 25 to the financial statements. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that other income was properly recorded. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the occurrence, completeness, accuracy, cut-off and classification of other income of R5 322 424.
29. There was no system of control over services charged on which I could rely for the purpose of my audit, and there were no satisfactory audit procedures that I could perform to obtain reasonable assurance that all the revenue was properly recorded. Furthermore, the municipality could not provide sufficient appropriate audit evidence for journals passed to the amount of R10 807 551. Consequently, I could not satisfy myself as to the completeness and accuracy of the amount of R20 959 348 as disclosed in note 15 to the financial statements.
30. The municipality did not provide the title deed listing obtained from the deeds office and therefore I was unable to satisfy myself as whether service charges were accurately charged to the transferred properties from the date of transfer with the correct amount. Consequently, I could not satisfy myself as to completeness and accuracy of the service charges to the amount of R20 959 348 as disclosed in note 15 to the financial statements.

#### **Irregular, fruitless & wasteful expenditure**

31. I could not satisfy myself as to the completeness of the irregular expenditure to the amount of R 20 922 975 and fruitless and wasteful expenditure to the amount of R 694 836 as disclosed in note 32 to the financial statements, as management has only disclosed amounts identified through the audit process.

#### **Commitments**

32. I could not satisfy myself as to the completeness of commitments disclosed in note 33.1 to the financial statements to the amount of R48 215 130 as management has only disclosed amounts identified through the audit process.

#### **Leases**

33. I could not satisfy myself as to the completeness of operating leases disclosed in note 33.2 to the financial statements to the amount of R1 240 574 as management has only disclosed amounts identified through the audit process.

#### **Disclaimer of opinion**

34. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

#### **Emphasis of matters**

I draw attention to the matters below. My opinion is not modified in respect of these matters:

#### **Significant uncertainties**

35. As disclosed in note 35 to the financial statements, the municipality is a defendant in the following lawsuits:
- Damage to Telkom cable
  - Citizen broken arm after falling into a trench dug by the municipality
36. The outcome of these lawsuits cannot be determined at present and no provision has been made for any liability that may result.

#### **Restatement of corresponding figures**

37. As disclosed in note 43.2 to the financial statements, the corresponding figures for 30 June 2009 have been restated as a result of an error discovered during the financial year ended 30 June 2010 in the financial statements of the municipality at, and for the year ended, 30 June 2009.

#### **Fruitless and wasteful, and irregular expenditure**

38. As disclosed in note 32.1 to the financial statements, fruitless and wasteful expenditure to the amount of R694 836 was incurred, as an appointed service provider did not succeed in the conversion of the financial statements for the financial periods ending 2008 and 2009 to comply with the SA Standards of GRAP.
39. As disclosed in note 32.2 to the financial statements, irregular expenditure to the amount of R20 522 975 was incurred, as a proper tender process had not been followed.

#### **Additional matters**

I draw attention to the matter below. My opinion is not modified in respect of this matter:

#### **Unaudited supplementary schedules**

40. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

#### **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

41. As required by the PAA and in terms of *General Notice 1570 of 2009* issued in *Government Gazette 32758* of 27 November 2009, I include below my findings on the report on

predetermined objectives, compliance with the following key laws and regulations: MFMA, Local Government: Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) and financial management (internal control).

#### **Predetermined objectives**

Included below are the findings resulting from the audit of the report on predetermined objectives.

#### **Non-compliance with regulatory requirements**

##### ***No reporting against predetermined objectives, indicators and targets***

42. The Thembisile Hani Local Municipality did not prepare the annual performance report in terms of section 46 of the MSA, and section 121(3)(c) of the MFMA.

#### ***Inadequate content of integrated development plan***

43. The key performance indicators set by the Thembisile Hani Local Municipality did not include any general key performance indicators applicable to the municipality, as prescribed in terms of section 43(1) of the MSA.

#### ***Existence and functioning of a performance audit committee***

44. The Thembisile Hani Local Municipality did not appoint and budget for a performance audit committee, nor was another audit committee utilised as the performance audit committee, as required by regulation 14(2) of the Municipal Planning and Performance Management Regulations, 2001.

#### ***Internal auditing of performance measurements***

45. The Thembisile Hani Local Municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurement as part of its internal audit processes, as required in terms of section 45 of the MSA.

#### ***Lack of adoption or implementation of a performance management system***

46. The Thembisile Hani Local Municipality did not adopt a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the roles of the different role players, as required in terms of sections 36, 38 and 41(2) of the MSA, and regulations 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001.

#### ***No mid-year budget and performance assessments***

47. The accounting officer of the Thembisile Hani Local Municipality did not (by 25 January of each year) assess the performance of the municipality during the first half of the financial year, taking into account the municipality's service delivery performance during the first half of the financial year and the service delivery targets and performance indicators set in the service delivery and budget implementation plan, as required by section 72 of the MFMA.

### **Usefulness of reported performance information**

48. The following criteria were used to assess the usefulness of the planned and reported performance:

- Consistency: Has the municipality reported on its performance with regard to its objectives, indicators and targets in its approved integrated development plan, i.e. are the objectives, indicators and targets consistent between planning and reporting documents?
- Relevance: Is there a clear and logical link between the objectives, outcomes, outputs, indicators and performance targets?
- Measurability: Are objectives made measurable by means of indicators and targets? Are indicators well defined and verifiable, and are targets specific, measurable, and time bound?

The following audit findings relate to the above criteria:

#### ***Planned performance targets not specific, measurable and time bound***

49. For the selected objectives, 50% of the planned and reported targets were not:

- specific in clearly identifying the nature and the required level of performance;
- measurable in identifying the required performance;
- time bound in specifying the time period or deadline for delivery.

#### ***Planned indicators not well defined***

50. For the selected objectives, 60% of the planned and reported indicators were not clear, with an unambiguous definition to allow for data to be collected consistently.

#### ***Planned and reported indicators not verifiable***

51. For the selected objectives, 60% of the planned and reported indicators were not verifiable, as it was not possible to validate the processes and systems that produce the indicator.

### **Compliance with laws and regulations**

#### **Municipal Finance Management Act**

##### **The annual report was not tabled by the mayor**

52. Contrary to section 127(2) of the MFMA, the mayor did not within seven months after the end of the financial year, table in the municipal council the annual report of the municipality.

##### **The accounting officer did not adhere to the reporting requirements on the monthly budget statements**

53. Contrary to section 71 of the MFMA, the accounting officer did not submit to the mayor and the provincial treasury, the monthly budget statements no later than 10 days after the end of each month.

**The accounting officer did not adhere to the reporting requirements on the quarterly budget statements**

54. Contrary to section 11(4) the accounting officer did not within 30 days after the end of each quarter table in the municipal council a consolidated report of all withdrawals made during the quarter and submit a copy to the relevant provincial treasury and the Auditor-General.

**The accounting officer did not adhere to the reporting requirements on the arrear accounts**

55. Contrary to section 63(3) of the MFMA, the municipality did not report to National Treasury on all accounts due for more than 30 days by organ of state.

**The accounting officer did not adhere to the requirements of collection of funds to the organs of state**

56. Contrary to section 64(4)(a) of the MFMA all revenue collected on behalf of other organs of state was not transferred to that organs of state at least on weekly basis.

**The audit committee was not fully functional**

57. Contrary to section 186(2) of the MFMA, the audit committee did not advise the municipal council, the political office bearers, the accounting officer and the management staff of the municipality of the matters detailed out in the section.

**Disclosure note not included in the financial statements**

58. Contrary to section 125 (1)(c), the notes to the financial statements of the municipality do not include the total amount paid in audit fees, taxes, levies, duties and pension and medical aid contributions and whether any amounts were outstanding as at the end of the financial year

**INTERNAL CONTROL**

59. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives as well as compliance with the MFMA, but not for the purpose of expressing an opinion on the effectiveness of internal control.
60. The matters reported below are limited to the significant deficiencies regarding the Basis for disclaimer of opinion paragraphs, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

• **Leadership**

*"Tone at the top", - an environment that is conducive to good accountability and service delivery through; positive attitude; integrity; competence; and ethical behaviour.*

- i) Performance is not measured
- ii) Integrity and ethical values are not developed and understood and do not set the standard for sound corporate governance.

***Oversight responsibility***

- i) The accounting officer does not exercise oversight responsibility over reporting and compliance with laws and regulations and internal control.
- ii) The systems are not documented in the policy and procedures manual and the results of the monitoring process are not routinely communicated to all managers and staff.
- iii) The accounting officer/authority does not evaluate whether management has implemented effective internal controls by gaining an understanding of how senior management has met its responsibilities.

***Decisive action to: mitigate emerging risks, implement timely corrective measures and address non performance***

- i) Actions are not taken to address risks relating to the achievement of complete and accurate financial and performance reporting.
- ii) Control weaknesses are not analysed, and appropriate follow-up actions are not taken that address root causes
- iii) Internal and external audit findings are not addressed.
- iv) The financial statements were subject to material amendments resulting from the audit.
- v) The financial statements and other information to be included in the annual report are not reviewed for completeness and accuracy prior to submission for audit.

• **Financial and performance management**

***Quality, reliable monthly financial statements and management information***

- i) The municipality does not have competent individuals who understand the financial reporting framework and performance management requirements. (Competence also refers to knowledge of the controls and related processes.)
- ii) Pertinent information is not identified and captured in a form and time frame to support financial and performance reporting.

***Proper record keeping and record management***

- i) Requested information was not available and supplied without any significant delay.

***Adequate financial management systems***

- i) General information technology controls are not designed to maintain the integrity of the information systems and the security of the data.
- ii) Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed.
- iii) Systems are not appropriate to facilitate the preparation of the financial statements and performance reports.

• **Governance**

***Risk identification and management designed to identify changes in processes or risks and verify that the design of underlying controls remains effective***

- i) The municipality does not identify risks relating to the achievement of financial and performance reporting objectives.
- ii) Internal controls are not selected and developed to prevent / detect and correct material misstatements in financial reporting and reporting on predetermined objectives.

***Fraud prevention, detection and response***

- i) A fraud prevention plan is not documented and used as per the requirements of applicable legislation.

***Internal audit that inspects the adequacy and implementation of internal control***

- i) Ongoing monitoring and supervision are not undertaken to enable an assessment of the effectiveness of internal control over performance reporting.
- ii) Internal control deficiencies are not identified and communicated in a timely manner to allow for corrective action to be taken.

***Audit committee that promotes independent accountability and service delivery***

- i) The audit committee did not fulfil its responsibilities as set out in legislation and in accordance with accepted best practice.

**OTHER REPORTS**

**Investigations in progress**

62. An investigation was conducted by an independent consulting firm on request of the municipality. The investigation was initiated based on the allegation of procurement of goods and services without following the appropriate supply chain processes. The investigation has resulted in the dismissal of the municipal manager.

Auditor-General  
Nelspruit

30 November 2010



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